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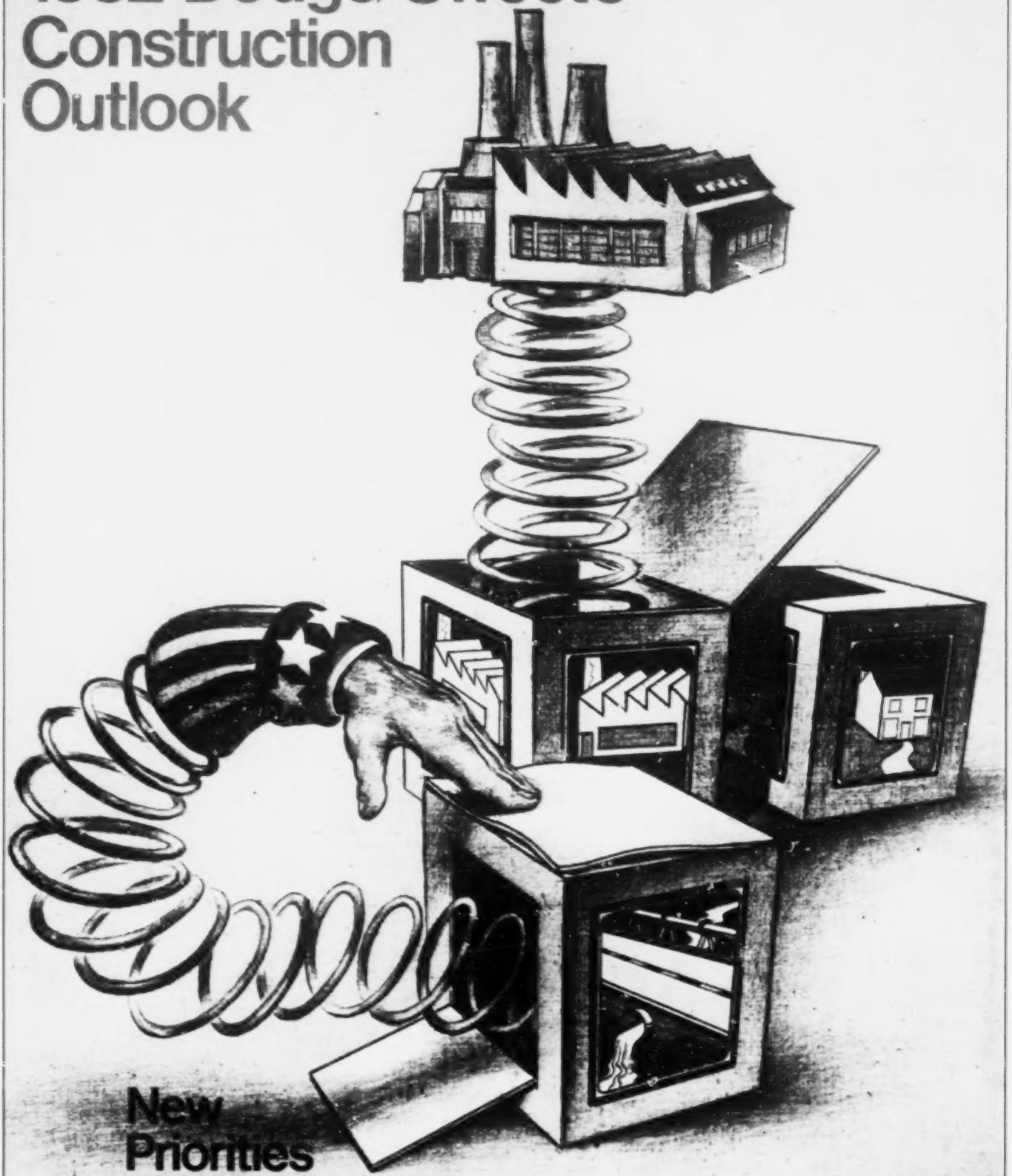
# 1982 Dodge/Sweet's Construction Outlook



## New Priorities for Construction

**The "Double Dip"**

Like the year before it, 1981 began with great expectations for the construction and building materials industries. The 1980s, after all, are the years when big things are supposed to be happening in the construction sector. Highly favorable demographic trends were to have finally helped this industry break out of a decade of sluggishness. Yet, the high hopes for 1981—like those for 1980 before them—quickly faded.

Both years, as interest rates soared, the Dodge Index of construction contracting plummeted (see chart). As contracting for new projects nosedived, work in progress dwindled, materials shipments declined, contractor failures rose, and unemployment in the building trades soared.

A dramatic switch from credit restraint to ease brought interest rates down sharply in 1980's second half, restoring vigorous expansion of construction activity. However, that favorable monetary environment—the basis for an optimistic 1981 forecast—lasted only until the end of the year, when another 180-degree turn of monetary policy set up 1981's "double dip." This time around the Fed seems determined to hang tough until it is convinced that the underlying causes of chronic inflation have been subdued. Taming inflation and restoring the economy's growth without renewed inflation are now the challenges to the Reagan Administration.

Whether or not the Reagan program is the best solution for the nation's economic problems is the subject for debate in another place. The issue here is: What does this program of tax reduction, budget cuts, investment subsidies, monetary restraint, and military escalation mean for the construction industry in 1982 and beyond? Will it eliminate, or at least reduce, the extraordinary volatility that has been the dominant pattern of building markets for the past two years? Is there room in this new set of priorities for the construction industry to begin to realize its long-awaited potential of the 1980s?

A few generalities concerning the Reagan Program for Economic Recovery, as it will affect construction, are immediately apparent:

- Budget cuts will severely restrict the availability of *public* funds for construction. At least 25% of all construction is publicly financed.
- Accelerated depreciation and deregulation are powerful incentives for *private* business capital spending, making commercial and industrial building obvious choices as the construction industry's best markets for the next few years.
- The Federal Reserve's restrictive monetary growth targets—endorsed by the Reagan Administration—remain a formidable barrier to the full recovery of the housing market.
- The coming military buildup is the other side of the budget cuts for construction and other non-DOD programs—the recurring guns-and-butter priority conflict set in a 1982 context.

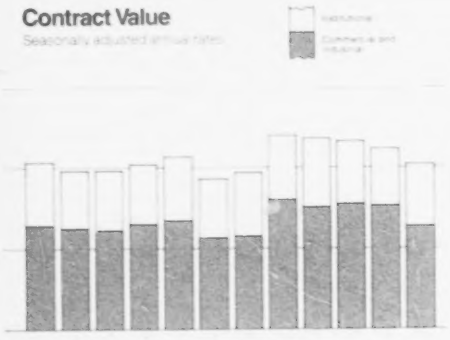
These issues, and a few others, are explored in greater depth in the appropriate sections of the *1982 Outlook*, which follows. For the technically oriented reader, a listing of assumptions about the expected behavior of the most critical economic variables affecting construction markets is provided at left.

## Assumptions

Key Economic Variables Affecting Construction in 1982

| | Annual Averages | | | 4th Quarter |
|---|---|---|---|---|
| | 1980 | 1981 | 1982 | 1982 |
| **Economic Growth** | | | | |
| Real GNP (% Change) | − 0.2 | + 2.0 | 2.5 | 4.8 |
| Ind Prod (% Change) | − 3.6 | + 4.0 | 4.5 | 6.2 |
| Cap. Util-Mfg. (%) | 79.0 | 79.5 | 81.0 | 83.0 |
| **Inflation** | | | | |
| GNP Deflator (% Change) | + 9.0 | + 9.0 | 8.2 | 8.6 |
| Consumer Price Index (% Change) | +13.5 | +10.2 | 8.5 | 8.4 |
| Comp. Const. Cost (% Change) | +10.7 | + 7.0 | 10.0 | 10.5 |
| **Interest Rates** | | | | |
| 90-Day T-Bill (%) | 11.43 | 14.45 | 12.50 | 12.00 |
| Mort (Conv/30 Yr/75%) (%) | 14.00 | 16.50 | 14.75 | 13.50 |
| **Employment/Unemployment** | | | | |
| Unemployment Rate (%) | 7.1 | 7.4 | 7.3 | 7.0 |
| White Collar Emp. (Millions) | 50.8 | 51.9 | 53.0 | 53.6 |
| **Bus. Cap. Spend** ($ billions) | 296 | 328 | 378 | 400 |
| **Fed Budget Deficit** | −61.2 | −57.0 | −58.0 | −56.0 |

**Contract Value**



On a reduced scale, the construction industry illustrates the general process, dubbed "reprivatization" by Administration officials, of reducing the economy's public-sector activities while expanding the role of private enterprise. Applied to construction, this redirection of resources means cutting budgets to reduce federal funds available for highways, waste-water-treatment facilities, and other public-works projects, while providing tax subsidies and promoting deregulation to create greater incentive for business capital spending. Investment in plant and equipment is, of course, the medium through which supply-side economics is expected to exert its leverage ("The trickle starts here."). Clearly, then, the first place to look for the positive effects of the Reagan program on construction markets is in private nonresidential building—or, more specifically, commercial and industrial building.

### Commercial/Industrial Construction

Alone among the several types of commercial and industrial construction, *office building* is doing exceedingly well in 1981 without any special help. As the sole survivor of the construction industry's "double-dip" recession, the booming office-building market is lending welcome support in an otherwise dismal year. Without this surge in office construction, nonresidential building would be nearly 10% behind last year's none-too-robust volume. As it is, square footage of total nonresidential contracting was slightly better than even with 1980 through the third quarter.

The office boom of 1980/81 has been gestating since the mid-1970s. Demographically based, it was a predictable event, much like the educational building boom of the 1960s. In fact, the very same people are responsible for both occurrences—previously as students, and more recently as employees.

Although record annual growth of the labor force in the second half of the 1970s was, by itself, reason enough for a boom in office building, there's more to it than that. The continuing trend toward employment in services (especially in the fast-gaining information industry), and a sharp rise in female participation in the labor force (from 43% in 1970 to 52% by 1980), meant that the growth in white-collar jobs outstripped the growth of the labor force in total. Relocation demand during the Southwestern migration of the 1970s added yet another dimension to the need for office space.

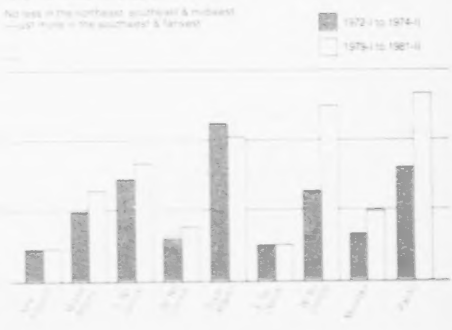
As these several forces converged in the marketplace, they triggered a building boom of heroic proportions. As early as 1978, contracting topped 200 million square feet, equaling the previous high for office building (1972). But that was only the beginning. In 1980, contracting rose to 244 million square feet. By mid-1981, a *further* 40% increase in contracting—to an annual rate in excess of 300 million square feet—gave reason to doubt the durability of the boom.

Soon, office building must settle back to a rate that is more appropriate to the slower growth of the white-collar labor force in the 1980s. For the past few years, only about two-thirds of the huge volume of newly started office construction has been in response to current demand. The balance was needed to reduce a large backlog of pre-existing need—especially in the burgeoning Southwest. By the end of 1981, the demand backlog—to the extent that it can be measured—will have been reduced to less than 100 million square feet.

The estimated 1982 total of 240 million square feet of contracting for offices, a 20% reduction from 1981's all-time peak, will consist of approximately 150 million square feet to satisfy newly created need, 75 million square feet to eliminate the remaining backlog of demand, and perhaps 15 million square feet of excess construction—the typical conclusion to office building cycles.

The probability that the office building boom has reached its peak

**A Tale Of Two Office Building Cycles**

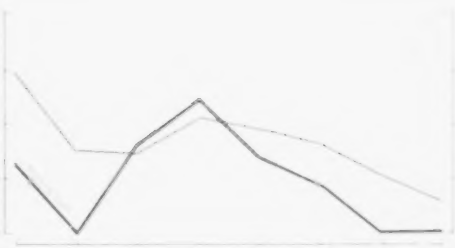


in 1981 sets a low limit on the potential for expansion of *total* nonresidential building, even though improvement is expected in many other markets. The gap left by offices next year will be filled mainly by the recovery of retail building and industrial construction.

In its typical fashion, contracting for *stores and warehouses* has been mirroring the ups and downs of the housing market through 1980 and 1981: down in the first half of 1980, up in the second half, and down again in 1981's first half (see chart). During this period of high volatility, the lead/lag relationship between housing and retail building seems to have shortened to something closer to three months than the customary six.

On an annual basis, the 1980/81 "double dip," which brought housing starts down 42% from a 1978 peak volume of 2 million units was almost equally damaging to retail building. Contracting for stores and warehouses, which crested in 1979 at 510 million square feet, declined 37% by 1981 to an estimated 320 million square feet.

**The Housing/Stores Relationship: 1980-81**



The recovery of homebuilding in 1982 will be the catalyst for an upturn in store and warehouse contracting. If 1981's third quarter was the bottom of the current housing cycle (at a seasonally adjusted annual rate of 975,000 dwelling units), contracting for stores and warehouses ought to be leveling off toward year-end in the range of 250 million to 260 million square feet; then, following housing, volume should climb again through 1982. A partial housing recovery in 1982 (details are given in the later section on residential building) will pull store/warehouse contracting upward through 1982. Due to the lagging response of retail building, 1982's total square footage will be little different from the 1981 total. However, the gain from fourth quarter to fourth quarter is likely to be a strong 35% to 40%.

*Industrial building* offers the construction industry's best opportunity for expansion—if not in 1982, then *starting* in 1982 and developing more fully in 1983. As the Reagan Administration strives to create a favorable environment for business capital spending (a rerun of the 1960s?), manufacturing facilities could become for the construction industry for the next two years what office building has been for the past two.

The incentives for investment—accelerated depreciation and deregulation—are already in place, but so are a couple of obstacles. After two quarters of declining real GNP (the inevitable consequence of 1981's exquisitely tight money), manufacturers are currently operating at less than 80% of capacity. At least one more quarter (1981-IV) of stagnation, and more likely two, lie ahead before the stimulus of tax reduction begins to revive the economy.

With this kind of slack in the manufacturing sector, 1982 capital spending is bound to be weighted

# 1982 National Estimates
# Dodge Construction Potentials

| Nonresidential Buildings | | 1980 Actual | 1981 Preliminary* | 1982 Forecast | Percent Change 1982/81 |
|---|---|---|---|---|---|
| **Floor Area** (millions of square feet) | Office Buildings | 244 | 300 | 240 | −20 |
| | Stores & Other Commercial | 441 | 385 | 370 | − 4 |
| | Manufacturing Buildings | 213 | 195 | 215 | +10 |
| | **Total Commercial & Manufacturing** | 898 | 880 | 825 | − 6 |
| | Educational | 95 | 75 | 75 | — |
| | Hospital & Health | 56 | 60 | 56 | − 7 |
| | Other Nonresidential Buildings | 146 | 124 | 112 | −10 |
| | **Total Institutional & Other** | 297 | 259 | 243 | − 6 |
| | **Total Nonresidential Buildings** | **1,195** | **1,139** | 1,068 | − 6 |
| **Contract Value** (millions of dollars) | Office Buildings | $ 13,466 | $ 18,450 | $ 16,375 | −11 |
| | Stores & Other Commercial | 11,336 | 10,800 | 11,500 | + 6 |
| | Manufacturing Buildings | 8,239 | 7,725 | 9,250 | +20 |
| | **Total Commercial & Manufacturing** | $ 33,041 | $ 36,975 | $ 37,125 | — |
| | Educational | $ 6,766 | $ 5,850 | $ 6,375 | + 9 |
| | Hospital & Health | 5,396 | 6,175 | 6,150 | — |
| | Other Nonresidential Buildings | 7,142 | 7,325 | 7,425 | + 1 |
| | **Total Institutional & Other** | $ 19,304 | $ 19,350 | $ 19,950 | + 3 |
| | **Total Nonresidential Buildings** | **$ 52,345** | **$ 56,325** | $ 57,075 | + 1 |

*Eight months actual; four months estimated.

## Residential Buildings

| | | 1980 Actual | 1981 Preliminary* | 1982 Forecast | Percent Change 1982/81 |
|---|---|---|---|---|---|
| **Dwelling Units** (thousands of units**) | One-Family Houses | 809 | 725 | 925 | +28 |
| | Multifamily Housing | 519 | 425 | 475 | +12 |
| | **Total Housekeeping Residential** | **1,328** | **1,150** | 1,400 | **+22** |
| **Floor Area** (millions of square feet) | One-Family Houses | 1,284 | 1,150 | 1,480 | +29 |
| | Multifamily Housing | 545 | 475 | 525 | +11 |
| | Nonhousekeeping Residential | 57 | 55 | 50 | — 9 |
| | **Total Residential Buildings** | **1,886** | **1,680** | 2,055 | **+22** |
| **Contract Value** (millions of dollars) | One-Family Houses | $ 41,474 | $ 40,825 | $ 57,725 | +41 |
| | Multifamily Housing | 18,519 | 17,700 | 21,525 | +22 |
| | Nonhousekeeping Residential | 3,213 | 3,575 | 3,575 | — |
| | **Total Residential Buildings** | **$ 63,206** | **$ 62,100** | $ 82,825 | **+33** |

## Nonbuilding Construction

| | | | | | |
|---|---|---|---|---|---|
| **Contract Value** (millions of dollars) | Highways & Bridges | $ 12,282 | $ 9,825 | $ 8,500 | —13 |
| | Sewer & Water | 7,591 | 7,275 | 6,550 | —10 |
| | Other Public Works | 7,156 | 5,750 | 5,450 | — 5 |
| | **Total Public Works** | $ 27,029 | $ 22,850 | $ 20,500 | —10 |
| | Utilities | $ 4,584 | $ 6,500 | $ 9,000 | +38 |
| | **Total Nonbuilding Construction** | **$ 31,613** | **$ 29,350** | $ 29,500 | **+ 1** |

## All Construction

| | | | | | |
|---|---|---|---|---|---|
| **Contract Value** (millions of dollars) | **Total Construction** | **$147,164** | **$147,775** | $169,400 | **+15** |
| | **Dodge Index** (1972 = 100) | 162 | 162 | 186 | |

*Eight months actual; four months estimated. **F. W. Dodge basis.

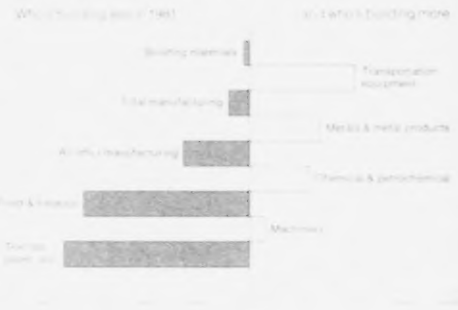
heavily in favor of machinery and equipment rather than buildings. Early emphasis on improving productivity and reducing unit costs is obviously what the framers of the 1981 tax legislation had in mind when they offered more liberal writeoffs for machinery than for structures.

Late in 1982, but more so in 1983, as the present slack in manufacturing is taken up by rising economic activity, efforts to produce at capacity limits could begin to add new inflationary pressures (through bottlenecks, overtime, etc.). Before this point is reached, the mix of investment must begin to shift to a higher proportion of buildings in order to provide the means for further expansion.

As capacity utilization in the manufacturing sector crosses over to the high side of 80% next year, contracting for industrial construction is expected to advance 10%, from 1981's total of 195 million square feet to 215 million. However, the gain between 1981's fourth-quarter low point to the final quarter of 1982 will be much larger. In 1983, more vigorous economic expansion and the new depreciation schedules are likely to encourage up to 250 million square feet of building, surpassing the previous 1979 peak.

A special note on synfuel plants: A few very large synthetic fuel projects are creating the same uncertainty in the forecasting of industrial building that nuclear power plants do in utility construction. These synfuel projects have been under negotiation for years, they cost in the billions, and their timing is anybody's guess. Like that of nuclear power plants, the fate of these major synfuel projects (two in Colorado; one in North Dakota) is at least as much a matter of politics as economics. In the interest of minimizing their distorting effects, these projects have been excluded from our 1982 estimates of construction contracting.

Industrial Construction



### Institutional Building

In the 1980s, the institutional building market—schools, hospitals, public buildings, etc.—faces a new impediment to growth: reduced funding.

Contacting for institutional buildings has been on a steadily descending course over the past decade, due mostly to non-financial reasons: unfavorable demographics (schools), or prior overbuilding (hospitals). However, toward the end of the 1970s, after 25% shrinkage from 400 million square feet in 1970 to 300 million in 1978, it began to look as if the necessary adjustment to current needs for these institutional facilities had finally been completed. Evidence of this was three years of stability, since 1978, at close to 300 million square feet per year.

In 1981, contracting for institutional building has fallen off its three-year plateau to an estimated 259 million square feet and is not likely to stabilize again until some new developments sort themselves out. This building market, which is *not* heavily

dependent on the federal government for construction financing, will nevertheless be experiencing federal budget backlash.

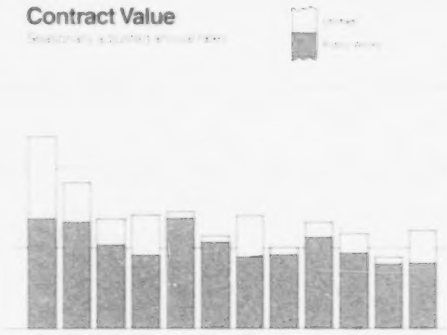
Deep cuts in federal support for social programs are putting a severe squeeze on state and local government finances. Analysis by the Joint Economic Committee of Congress indicates that federal grants to cities and states, which account for less than 20% of the federal budget, are absorbing two-thirds of the budget cuts. Block grants will restore some support in fiscal year 1982, but on balance, these programs will be left with about 30% less federal funding. As this void develops, the urgency of social needs is bound to receive a higher priority than local building programs. With health care, school lunches, and student loans competing for scarce state and municipal dollars, some marginal building projects are certain to be displaced.

## The Outlook

**Nonresidential Building Contract Value**

Seasonally adjusted annual rates, in billions of dollars

| Year/Quarter | | Total | Commercial/ Industrial | Institutional |
|---|---|---|---|---|
| **1981** | I | $59.3 | $38.1 | $21.2 |
| | II | 58.3 | 39.5 | 18.8 |
| | III | 56.2 | 38.0 | 18.2 |
| | IV | 51.3 | 32.4 | 18.9 |
| **1982** | I | 54.3 | 34.7 | 19.6 |
| | II | 55.9 | 36.3 | 19.6 |
| | III | 58.1 | 38.0 | 20.1 |
| | IV | 60.0 | 39.3 | 20.7 |
| **1981** | | $56.3 | $37.0 | $19.3 |
| **1982** | | 57.1 | 37.5 | 20.0 |
| **% Change** | | +1% | — | +3% |




In the White House report "A Program for Economic Recovery"—which is nothing less than the basic text for Reaganomics—the Administration leaves little doubt about its intentions concerning federal public-works programs. The key words are "stretchout" and "re-target." Applied on a program-by-program basis, stretching out and re-targeting would achieve the following goals:

- **Highway construction grants:** "The Administration's highway program proposal will involve slowing down construction of lower priority highway projects. The proposed changes in the Federal highway program will produce budget savings of approximately $12.6 billion by 1986."
- **Waste treatment grants:** "The application of the deferral principle to the municipal waste treatment grant program will reduce near-term outlays for capital investments by $0.1 billion in 1982, $1.0 billion in 1983, and $2.0 billion in 1986."
- **Water resource projects:** "The Administration will propose an 11% reduction in the planned construction programs of the Corps of Engineers (Civil); Water and Power Resources; and Soil Conservation Service."
- **Mass transit capital grants:** "The reduced funding levels for mass transit capital grants are primarily achieved by reducing the amount of funds for constructing new rail transit systems and extending existing systems. Grants to purchase buses and update existing rail systems will be continued."
- **Airport construction grants:** "The Administration will propose legislation to reduce the annual funding available for airport construction grants during 1981-1986 by 33%."

In total, these proposals add up to a five-year cutback of between $20 billion and $25 billion from amounts authorized under already-existing federal public-works programs. Because Congress accepted these cuts in principle last July—*before* it became evident that FY82's deficit was headed for a large overrun—it can only be expected that public works (along with most other non-DOD programs) will soon be *re*-re-targeted.

Reduction of federal spending for public works is apt to provoke a perverse reaction in the case of programs which require states and municipalities to provide matching funds. The oft-stated intent of the Reagan Administration is to shift the burden of most non-defense activities of the federal government to the local level. After a period of adjustment, cutting back federal grants for public works will undoubtedly bring forth more *local* funding, though probably not as much as a combined federal/local total. In the meantime, however, reduction of federal grants could result in the additional loss of local *matching* funds for highways, sewer and waste-treatment facilities, and other projects.

In July, the Administration persuaded the Congress to accept a budget that would hold next year's outlays for public-works construction to between 85% and 90% of the total authorized by existing legislation. Applied against 1982's higher authorizations, this works out to about 5% less than 1981's actual spending. However, a forthcoming second round of budget cutting to contain FY82's ballooning deficit could raise that 5% pruning to as much as 10% or 15%, depending on how Congress reacts to the President's September call for a further 12% across-the-board cut in non-defense programs.

The outlook for contracting in this highly controllable construction market is only a matter of determining the extent of next year's decline. Additional slippage of 5% beyond 1981's initial cuts would seem to be the least that must be expected, while a budget "crisis" could easily precipitate another freeze on public-works funding as a stopgap measure. Prudence in forecasting suggests that it would be better to anticipate a decline of more like 10% in 1982 contract value, with the heaviest cuts—as always—in highway/bridge construction and EPA-funded projects.

### Utilities

After a full year (1980) of severely depressed contracting for electric generating plants, 1981 brought little improvement. For two consecutive years, starts of new generating capacity have barely equaled one-quarter of the $20-billion annual level achieved not long ago.

Few industries have undergone a "personality change" equal to that of the electric utilities. From booming growth in the mid-1970s—when nuclear generation seemed the obvious answer to the energy crisis—this industry is currently coping with excess capacity, lowered expectations of future energy requirements, and disenchantment with the nuclear alternative. Because none of these hard realities is subject to short-term reversal, there is little reason to expect any more than nominal improvement in construction contracting for generating facilities in 1982.

Things are quite different in the natural gas industry. In 1981, the start of another segment of the Alcan gas pipeline (along the northwestern U.S. border) added $1.5 billion to the year's total of utility construction. This on-and-off project, with a total construction value estimated at more than $14 billion, has the strong backing of the Reagan Administration. White House support behind regulatory changes that would aid financing is expected to accelerate the pipeline's completion. Another $3 billion of contracting, most of it in Alaska, is scheduled for 1982, and it represents the difference between a strong increase or little change in utility construction next year. Experience shows that neither the timing nor the amount of such large undertakings is in any way certain.

## The Outlook

### Nonbuilding

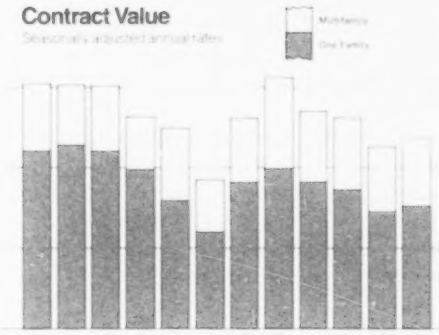
**Construction Contract Value**

Seasonally adjusted annual rates, in billions of dollars

| Year/Quarter | | Total | Public Works | Utilities |
|---|---|---|---|---|
| **1981** | I | $33.5 | $28.1 | $ 5.4 |
| | II | 30.0 | 22.8 | 7.2 |
| | III | 22.4 | 20.2 | 2.2 |
| | IV | 31.5 | 20.4 | 11.1 |
| **1982** | I | 29.4 | 20.4 | 9.0 |
| | II | 29.1 | 20.1 | 9.0 |
| | III | 29.6 | 20.6 | 9.0 |
| | IV | 29.9 | 20.9 | 9.0 |
| **1981** | | $29.4 | $22.9 | $ 6.5 |
| **1982** | | 29.5 | 20.5 | 9.0 |
| **% Change** | | +1% | −10% | +38% |

**Contract Value**

Seasonally adjusted annual rates



The Reagan Administration's *non*-policy on housing has been articulated frequently by its top officials. The best way, they say, to solve the nation's housing problem is to restore general economic health and vitality and to reduce inflation. This is, of course, a corollary to the axiom which forms the foundation of Reaganomics: All segments of the economy will have the opportunity to advance once the Program for Economic Recovery takes effect.

History shows, however, that for housing, the "magic of the marketplace" is an illusion. Housing needs are usually among the last to be served by a fully competitive market. Oftentimes, satisfaction of housing demand must be deferred until periods of general slack when other claims on the economy's resources and credit have temporarily diminished.

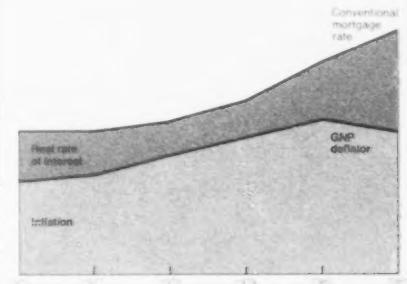
For the housing industry, the Administration's commitment to a "trickle down" theory of economics means operating at a disadvantage. Coupled with an equally firm commitment to monetarism, Reaganomics adds handicap to disadvantage. It assumes that the housing market will eventually realize its 2-million-unit annual potential, but requires that it be done the hard way—without subsidy, and in an environment of credit restraint.

For the second time in as many years, overzealous credit restraint has reduced the rate of housing starts to only 1 million units. Under such circumstances, the two most urgent issues for 1982 are (1) interest rates and (2) interest rates.

A general decline of interest rates is essential to a recovery of homebuilding, and there are several ways it could come about:

- Because inflation establishes the "floor" under long-term interest rates, the ideal way to bring interest rates down to stay would be by means of a several-percentage-point decline in the rate of inflation.
- An effective, but hardly desirable way to pull interest rates down is to create a recession. Extreme monetary restraint, applied long enough, is capable of achieving this questionable goal.
- Reduced federal government borrowing would relieve a significant amount of pressure on interest rates. To finance its $57-billion deficit in 1981, the federal government syphoned off one-third of the scarce supply of loanable funds.
- Still another route to lower interest rates in 1982 is the most obvious of all—a relaxation of monetary restraint by the Federal Reserve. Administration pressure for more accommodation by the Fed is mounting now that the Reaganauts have begun to shift the blame for high interest rates from Wall Street to Constitution Avenue. But is the "independent" Fed listening?

**Mortgage Rates: Out of line with inflation in 1981?**




The best chance for a decline of interest rates in 1982 would develop out of a combination of all these influences on the money markets. A breakthrough in inflation is unrealistic, but with most interest rates so far above the inflation "floor," there is room for them to decline significantly without endangering the so-called *real* rate of interest. A sluggish economy through mid-1982 should limit business demand for credit in the short run. Federal borrowing needs could be significantly reduced if the Defense Department were not sheltered from budgetary restraint. The Federal Reserve could relax the *degree* of its restraint—

without compromising its basic monetarist stand—simply by aiming for the top (or even the middle) of its monetary growth range, instead of the bottom.

Even if one or another of these downward forces on interest rates should fizzle, there are enough of them to justify an expectation of moderately lower rates in 1982. The key assumptions underlying next year's housing forecast are that short-term interest rates will average about 200 basis points below the 1981 level. Mortgages, which have averaged 16.5% in 1981 (and briefly flirted with 18%), will ease to an average of 14.75% in the year ahead. It must be recognized, however, that the money markets are highly vulnerable to external shocks. A surging federal budget deficit, a sharp jump in inflation due to a boost of oil prices, or even a capital-goods boom could prompt action by the Fed that would send rates soaring again.

Experience with housing activity when mortgages are in the lofty range between 14% and 17% is exceedingly limited. In fact, all that is known is what happened when rates went *up* from 14% past 17% in 1981. What happens when they go in the other direction remains to be seen. After two full years of very low-volume building, a decline to 14% could conceivably bring forth as many housing starts as a 12% mortgage did in 1979.

Before that happens, however, the thrift institutions will need a period in which to repair their balance sheets before embarking on a new

# 1982 Regional Estimates
# Dodge Construction Potentials

**Northeast** — Connecticut, District of Columbia, Delaware, Massachusetts, Maryland, Maine, New Hampshire, New Jersey, New York, Eastern Pennsylvania, Rhode Island, Virginia, Vermont

| | | 1980 Actual | 1981 Preliminary* | 1982 Forecast | Percent Change 1982/81 |
|---|---|---|---|---|---|
| Contract Value (millions of dollars) | **Nonresidential Buildings** | | | | |
| | Commercial and Manufacturing | $ 5,634 | $ 7,000 | $ 6,850 | − 2 |
| | Institutional & Other | 3,993 | 4,250 | 4,300 | + 1 |
| | **Total** | $ 9,627 | $11,250 | $11,150 | − 1 |
| | **Residential Buildings** | | | | |
| | One-Family Houses | $ 5,752 | $ 5,875 | $ 8,550 | +46 |
| | Multifamily Housing | 3,124 | 3,125 | 3,675 | +18 |
| | Nonhousekeeping Residential | 517 | 775 | 650 | −16 |
| | **Total** | $ 9,393 | $ 9,775 | $12,875 | +32 |
| | **Nonbuilding Construction** | | | | |
| | Highways and Bridges | $ 2,712 | $ 1,675 | $ 1,525 | − 9 |
| | Other Public Works | 3,726 | 2,700 | 2,450 | − 9 |
| | Utilities | 281 | 500 | 600 | +20 |
| | **Total** | $ 6,719 | $ 4,875 | $ 4,575 | − 6 |
| | **Total Construction** | **$25,739** | **$25,900** | $28,600 | +10 |

**Midwest** — Northern Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, North Dakota, Ohio, Western Pennsylvania, South Dakota, Wisconsin, West Virginia

| | | | | | |
|---|---|---|---|---|---|
| Contract Value (millions of dollars) | **Nonresidential Buildings** | | | | |
| | Commercial and Manufacturing | $ 7,045 | $ 6,825 | $ 7,150 | + 5 |
| | Institutional & Other | 4,658 | 4,375 | 4,425 | + 1 |
| | **Total** | $11,703 | $11,200 | $11,575 | + 3 |
| | **Residential Buildings** | | | | |
| | One-Family Houses | $ 6,897 | $ 6,050 | $ 8,775 | +45 |
| | Multifamily Housing | 3,059 | 2,850 | 3,350 | +18 |
| | Nonhousekeeping Residential | 443 | 550 | 500 | − 9 |
| | **Total** | $10,399 | $ 9,450 | $12,625 | +34 |
| | **Nonbuilding Construction** | | | | |
| | Highways and Bridges | $ 2,893 | $ 2,675 | $ 2,350 | −12 |
| | Other Public Works | 3,054 | 2,650 | 2,475 | − 7 |
| | Utilities | 490 | 2,550 | 2,850 | +12 |
| | **Total** | $ 6,437 | $ 7,875 | $ 7,675 | − 3 |
| | **Total Construction** | **$28,539** | **$28,525** | $31,875 | +12 |

*Eight months actual; four months estimated.

## South

Alabama, Arkansas, Florida, Georgia, Southern Illinois, Kansas, Louisiana, Mississippi, Missouri, North Carolina, Nebraska, Oklahoma South Carolina, Tennessee, Texas

| Contract Value (millions of dollars) | 1980 Actual | 1981 Preliminary* | 1982 Forecast | Percent Change 1982/81 |
|---|---|---|---|---|
| **Nonresidential Buildings** | | | | |
| Commercial and Manufacturing | $11,759 | $13,550 | $13,575 | — |
| Institutional & Other | 6,512 | 6,700 | 7,000 | + 4 |
| **Total** | $18,271 | $20,250 | $20,575 | + 2 |
| **Residential Buildings** | | | | |
| One-Family Houses | $17,854 | $18,825 | $26,400 | +40 |
| Multifamily Housing | 7,010 | 7,175 | 8,675 | +21 |
| Nonhousekeeping Residential | 1,276 | 1,325 | 1,375 | + 4 |
| **Total** | $26,140 | $27,325 | $36,450 | +33 |
| **Nonbuilding Construction** | | | | |
| Highways and Bridges | $ 4,431 | $ 3,650 | $ 3,100 | −15 |
| Other Public Works | 4,899 | 4,350 | 4,025 | − 7 |
| Utilities | 2,237 | 1,700 | 2,200 | +29 |
| **Total** | $11,567 | $ 9,700 | $ 9,325 | − 4 |
| **Total Construction** | **$55,978** | **$57,275** | $66,350 | +16 |

## West

Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming

| Contract Value (millions of dollars) | 1980 Actual | 1981 Preliminary* | 1982 Forecast | Percent Change 1982/81 |
|---|---|---|---|---|
| **Nonresidential Buildings** | | | | |
| Commercial and Manufacturing | $ 8,603 | $ 9,600 | $ 9,550 | — |
| Institutional & Other | 4,141 | 4,025 | 4,225 | + 5 |
| **Total** | $12,744 | $13,625 | $13,775 | + 1 |
| **Residential Buildings** | | | | |
| One-Family Houses | $10,971 | $10,075 | $14,000 | +39 |
| Multifamily Housing | 5,326 | 4,550 | 5,825 | +28 |
| Nonhousekeeping Residential | 977 | 925 | 1,050 | +14 |
| **Total** | $17,274 | $15,550 | $20,875 | +34 |
| **Nonbuilding Construction** | | | | |
| Highways and Bridges | $ 2,246 | $ 1,825 | $ 1,525 | −16 |
| Other Public Works | 3,068 | 3,325 | 3,050 | − 8 |
| Utilities | 1,576 | 1,750 | 3,350 | +91 |
| **Total** | $ 6,890 | $ 6,900 | $ 7,925 | +15 |
| **Total Construction** | **$36,908** | **$36,075** | $42,575 | +18 |

*Eight months actual; four months estimated.

round of lending. (This may be the major benefit from All Savers deposits in the closing months of 1981.) Although 1981's fourth quarter is not likely to show much improvement over the badly depressed third, a modest recovery should take hold in the first quarter of next year. With acceleration in the second half of 1982, the final quarter's rate of housing starts may be as high as 1.6 million, bringing the year's total to 1,400,000 dwelling units. Of this amount 925,000 are estimated to be one-family homes, and 475,000 will be apartments or condominiums.

At 1982 prices, the contract value of all residential building, including nonhousekeeping residential structures (hotels, motels, dormitories) is estimated to be $82.8 billion, up 33% from 1981's deeply depressed total.

## The Outlook

### Residential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

| Year/Quarter | | Total | One Family | Multi-Family* |
|---|---|---|---|---|
| 1981 | I | $67.7 | $45.5 | $22.2 |
| | II | 65.1 | 43.2 | 21.9 |
| | III | 56.8 | 36.4 | 20.4 |
| | IV | 58.5 | 38.1 | 20.4 |
| 1982 | I | 66.6 | 45.0 | 21.6 |
| | II | 77.0 | 52.5 | 24.5 |
| | III | 89.7 | 63.4 | 26.3 |
| | IV | 98.0 | 70.0 | 28.0 |
| 1981 | | $62.1 | $40.8 | $21.3 |
| 1982 | | 82.8 | 57.7 | 25.1 |
| % Change | | +33% | +41% | +18% |

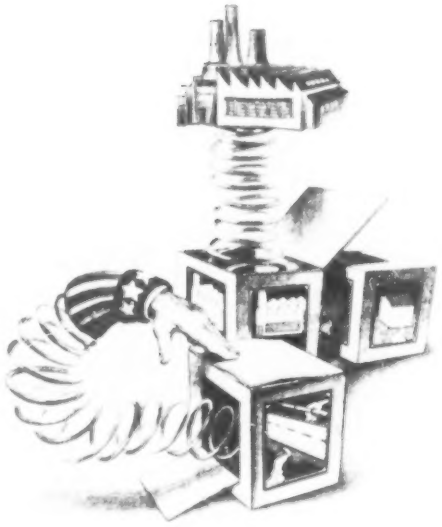
*Includes Nonhousekeeping Residential Buildings

In 1982, as gains in private nonresidential building and declines in publicly financed construction pretty much cancel one another out, the one part of the construction market that has no assigned place in Reaganomics—housing—will play a pivotal role.

It is unlikely that the excessively high interest rates that have been so damaging to the housing market in 1981 will prevail much longer. The Fed's latest round of ultra-restraint of the money supply, which made conditions all but unworkable for the housing market, is also making things uncomfortable for the Administration. The government's cost of borrowing soared along with everyone else's, while its revenue projections—based on meager prospects for the economy's near-term growth—diminished. Responsibility for a substantial deficit overrun in fiscal year 1982, which threatens to undermine the Administration's economic program in its early stages, is being laid at the doorstep of the Federal Reserve.

In 1982, a partial accommodation by the Fed to the Administration's budgetary squeeze would—quite unintentionally—allow a partial recovery of housing as interest rates recede from their lofty peaks. The strength of housing's response is something of a guessing game at this point, but a modest decline of mortgage rates should bring next year's housing starts within the range of 1.4 million to 1.5 million dwelling units. Although the lower end of this range is the safer choice, even that small an advance would be enough to raise the total of all construction in 1982 by 5% in real terms. In 1982 prices, next year's contract value of $169.4 billion would be a 15% improvement over 1981's depressed $147.8 billion total.

The revival of residential building will dominate the construction sector through much of 1982. However, housing's expansion will stall long before reaching full recovery, since the Reagan Administration is only a little less committed to monetarism than the Federal Reserve is. Sustained monetary restraint—but short of the Fed's hard-line position—is as much a part of the Administration's economic program as are tax cuts and budget cuts, which means that interest rates will not fall far. Once the housing market settles on a higher plateau that is consistent with moderately lower interest rates, the fuller consequences of the Reagan program on the construction industry will become more apparent.



The priorities of Reaganomics are, on balance, more suppressive than supportive of construction. Militarization and industrialization—the Administration's foremost objectives—simply do not involve much in the way of construction. Less than 5% of the DOD budget is construction; the overwhelming balance is military hardware and payrolls. Only 20%, at best, of business capital spending is construction; the rest is equipment and vehicles. The potential for growth of construction through militarization and industrialization is limited and narrow compared with the potential it displaces in public works (through non-DOD budget cuts) and in housing (through sustained monetary restraint). These are some of the trade-offs that the Reagan program requires.

Beyond the several-year period of transition that this program will require to accomplish its goals, there is reason to expect that much of the deferred construction potential of the early 1980s can eventually be realized. But it will only happen if two critical conditions are met: local governments must assume responsibility for the programs that the federal government is abandoning, and inflation must subside enough to permit interest rates to return to a workable level. Unlike tax cuts and budget cuts, these changes cannot be legislated. When—and *only* when—they finally happen can the construction and building-materials industries again approach full-scale operation.

## The Outlook

### Total Construction Contract Value

Seasonally adjusted annual rates,
in billions of dollars

| Year/Quarter | | Non-residential Building | Residential Building | Nonbuilding Construction | Total Construction |
|---|---|---|---|---|---|
| **1981** | I | $59.3 | $67.8 | $33.5 | $160.6 |
| | II | 58.3 | 65.2 | 30.0 | 153.5 |
| | III | 56.2 | 56.9 | 22.4 | 135.5 |
| | IV | 51.3 | 58.6 | 31.5 | 141.4 |
| **1982** | I | 54.3 | 66.6 | 29.4 | 150.3 |
| | II | 55.9 | 77.0 | 29.1 | 162.0 |
| | III | 58.1 | 89.7 | 29.6 | 177.4 |
| | IV | 60.0 | 98.0 | 29.9 | 187.9 |
| **1981** | | $56.3 | $62.1 | $29.4 | $147.8 |
| **1982** | | 57.1 | 82.8 | 29.5 | 169.4 |
| **% Change** | | +1% | +33% | +1% | +15% |

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